



Treasury Inspector General for Tax Administration Office of Audit

REPEATED EFFORTS TO MODERNIZE PAPER TAX RETURN PROCESSING HAVE BEEN UNSUCCESSFUL; HOWEVER, ACTIONS CAN BE TAKEN TO INCREASE ELECTRONIC FILING AND REDUCE PROCESSING COSTS

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Highlights

Highlights of Report Number: 2009-40-130 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

In Calendar Year 2008, the Internal Revenue Service (IRS) received 156.3 million individual income tax returns of which 66.4 million (42.5 percent) were paper-filed. The IRS has devoted significant resources to identify ways it could modernize its method for processing paper tax returns but has had no success. Actions can be taken including mandating electronic filing (*e-filing*) for paid preparers and developing processes to convert paper returns into an electronic format which would significantly reduce paper filings, processing costs, and error rates, with the added benefit of faster tax refunds and more accurate tax returns for taxpayers.

WHY TIGTA DID THE AUDIT

This audit was initiated to assess the IRS' strategy to convert paper-filed individual income tax returns into an electronic format. The IRS continues to receive large numbers of paper-filed individual income tax returns despite a continued growth in *e-filing*. Processing of paper-filed tax returns costs the IRS approximately \$190.6 million.

WHAT TIGTA FOUND

Repeated efforts have been initiated to modernize paper tax return processing with no success. Significant resources have been expended on developing modernization concepts. Since at least as far back as 1988, the IRS has attempted to develop a system to replace its current paper tax return processing. However, these efforts have resulted in little more than conceptual visions.

While the IRS has not been able to move beyond the conceptual stage for modernizing paper processing, there are actions that would reduce paper filings and/or convert paper tax returns into an electronic format.

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These options could result in a significant increase in *e-filing* as well as significant processing cost savings to the IRS. The options are:

- Mandate *e-filing* for paid preparers (this option would require a change in the law). The majority of paid preparers are already familiar with operating in an electronic environment. Most paid preparers who filed paper tax returns actually used an electronic tax software preparation package and 70 percent also *e-filed* at least 1 tax return, which indicates a familiarity with the electronic preparation and *e-filing* process.
- Convert residual paper returns into an electronic format. Updating the Modernized Submission Processing concept to include pursuing successful processes followed by States that use scanning technology could provide the IRS with an option to convert paper-filed tax returns into an electronic format, thereby reducing processing costs associated with paper-filed tax returns.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division, pursue implementing successful processes followed by States that use scanning technology (Optical Character Recognition and Two-Dimensional Bar Codes) to convert paper-filed tax returns prepared by individuals using a tax preparation software package into an electronic format. TIGTA also made a legislative recommendation to consider mandating *e-filing* for all paid preparers.

In their response to the report, IRS officials agreed with the recommendations. The Wage and Investment Division plans to pursue the implementation of processes that use scanning technology (Optical Character Recognition and Two-Dimensional Bar Codes). Two-Dimensional Bar Codes will be a project proposal for the 2012 Modernization Vision and Strategy planning cycle. In the meantime, the IRS plans to submit a new proposal to enhance legacy systems with Two-Dimensional Bar Code capabilities. The IRS also agreed with the legislative recommendation and stated that it is currently under consideration by the Department of the Treasury and included in the President's Fiscal Year 2010 budget request.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2009reports/200940130fr.pdf>

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